

Growing... ... in a slowing world

By

Jean Estin

Chairman & CEO Estin & Co

In a globalized economy, an investor's cost of capital is simply the return they can expect from average stock market growth – which, over the long term, aligns with global economic growth – plus dividend distributions.

This growth has been declining in real terms over the past 40 years and is expected to continue decreasing over the next 30 years. Two key factors drive this trend:

- *World Population Growth (Excluding Africa¹)*: This has slowed from 1.7% per year in the 1960s to 0.5% per year² in the 2020s and is expected to drop further to 0.3% per year in the 2030s. China, whose population grew at 1.6% per year in the 1980s and 0.6% per year between 2000 and 2020, now faces population decline (- 0.1% per year in the 2020s). Its demographic trajectory is about 20 years behind Japan's. No other major country or region outside Africa is catching up; for instance, India's population growth has already slowed to 0.8% per year.
- *Productivity Growth³*: In the 1960s, productivity drove 3% global GDP growth⁴, declining to 1.5% in the 1990s and 2000s, and now stands at around 1% in the 2020s. It is expected to contribute only 0.5% to 1% growth in the 2030s. The main driver of productivity growth is not technological progress in developed countries, but rather the rise of emerging economies. Between 1980 and 2020, China's emergence as a major global industrial player sustained global productivity levels. However, this impact will diminish in the coming decades. India is a significant contributor but is unlikely to offset both China's slowing growth and Europe's stagnation.

In nominal terms, the third growth factor is *inflation*: it was around 8% in the 1970s⁵, declined to 3% in the 1990s and 2000s, and further fell to 1% in the 2010s. It is expected to rise back to 2.5–3%, with high volatility due to economic shocks such as the energy transition, resource scarcity, partial de-globalization, armed conflicts, and aging populations. However, this rise will obscure the fact that, in real terms, the cost of capital will continue to fall (*see table*).

¹ World excluding Sub-Saharan Africa, North Africa and West Asia, as defined by the World Bank and United Nations. Africa, according to the most likely scenarios, will represent 20% of the world population in 2035 and less than 3-4% of global GDP in nominal terms. If the region is to materially impact the world economy and its growth, it will be after 2035, or even 2040.

² Figures based on estimates and projections of the United Nations central scenario (median variant); from 1 January of the beginning of the period to 1 January of the end of the period (example: 1 January 1960 to 1 January 1970 for the 1960s).

³ For historical periods, estimates from the World Bank and the IMF unless otherwise stated. For projections, macroeconomic estimates from Estin & Co.

⁴ Estimate from the Maddison Project of the University of Groningen (GDP per capita growth in constant 2011 dollars between 1960 and 1970).

⁵ Estin & Co estimate.

The Value of Long-Term Growth

In an environment of declining average economic growth and falling real costs of capital, a company that maintains the same (real) growth rate creates increasing value. Its valuation multiples increase.

Over the past decade, the world's leading companies have grown at rates exceeding 10% annually. Their valuation multiples have increased much faster than the broader stock market, and this trend will likely continue – potentially even accelerate – excluding inflationary effects. Companies generating strong, profitable, and sustained long-term growth (over 10-20 years) with high visibility will benefit the most.

The ability to have successive phases of strategic growth using different levers, growth modes and long-term playing fields is a major skill.

Market Power and Inflation

The resurgence of inflation introduces another dimension to this phenomenon. Beyond masking declining economic growth and the cost of capital in real terms, inflation impacts businesses differently across industries and regions.

Some businesses and geographies are better positioned to pass cost inflation onto clients, depending on client type, purchasing power, behavior sophistication... Within each industry, market leaders often have significantly more pricing power than smaller competitors. Their ability to translate inflation-driven cost increases into higher prices depends on market share, product differentiation, brand strength, and service offerings. As a result, they can fully integrate inflation into their revenue growth and profitability, whereas weaker competitors may see inflation erode their margins and destroy value.

Inflation alters the relative attractiveness of industries and geographies, reduces margins for weaker market players, and accelerates industry consolidation. This dynamic forces companies to reassess and optimize their business portfolios.

Value Creation

For a large company with long-term growth, maintaining its historical growth rate in real terms is already challenging when global economic expansion slows. Even in *nominal terms (including inflation)*, this will not be sufficient. Inflation will have to be translated back into revenue growth if multiples are to be maintained, and growth accelerated beyond the real growth rate. Market leaders will succeed in doing so. Further value creation must come from *increased EBIT* growth – not just potential re-rating.

Long-term growth, industry leadership, differentiation, business selection, the impact of inflation... are not new concepts. However, in a world of slowing real economic growth and rising inflation, making the right strategic choices becomes even more critical. As inflation returns, valuation multiples will decline – but not for everyone.

Jean Estin

September 2023

Estin & Co is an international strategy consulting firm, with offices in Paris, London, Zurich, New York and Shanghai. The company assists senior executives of major European, North American and Asian corporations with their growth strategies, and managers of private equity firms with the analysis and valuation of their investments.

ESTIN & CO

PARIS - LONDON - ZURICH - NEW YORK - SHANGHAI

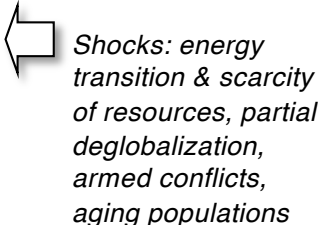
32, AVENUE KLEBER - 75116 PARIS

TEL: +33 1 56 59 87 87 - FAX: +33 1 56 59 87 88 - <https://estin.com>

- Table -

The average cost of capital of global stock markets will decrease to 4% *in real terms* over 2022-2035; but in nominal terms it will increase to 7% *with inflation*

- World -

	1990-2008	2008-2022	2022-2035	
Population growth	1,2%	0,9%	0,5%	
Productivity gains⁽¹⁾	1,6%	1,4%	1,1%	
Real growth	2,8%	2,4%	1,5%	
	_____	_____	_____	
Dividends	2,5%	2,5%	2,5%	
	_____	_____	_____	
TSR ⁽²⁾ real (K_e)⁽³⁾	5,3%	4,9%	4,0%	
Inflation	2,7%	1,0%	2,8%	
TSR ⁽²⁾ nominal (K_e)⁽³⁾	8,1%	5,9%	6,9%	

Note: Rounded figures

(1) Productivity gains represent the increase in GDP per capita in “volume”. Aggregate productivity gains for countries that do share a currency are calculated in constant dollars (constant local currencies converted into dollars at constant rates); (2) TSR = Total Shareholder Return = capital appreciation plus distributions (dividends, etc.); (3) K_e = equity cost of capital

Sources: World Bank, IMF, Estin & Co analysis and estimates